

BEFORE THE PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA

California Water Service Company
(U 60-W), for authority to increase
rates charged for Water Service in the
Antelope Valley District by \$437,218
or 36.94% in fiscal year 2006-2007; by
\$145,000 or 8.94% in fiscal year
2007-2008; and by \$145,000 or 8.21%
in fiscal 2008-2009
And Related Matters.

Application 05-08-006
(Filed August 8, 2005)

A.05-08-007
A.05-08-008
A.05-08-009
A.05-08-010
A.05-08-011
A.05-08-012
A.05-08-013

**REPLY BRIEF
OF THE DIVISION OF RATEPAYER ADVOCATES**

Pursuant to Rule 75 of the California Public Utilities Commission (Commission) Rules of Practice and Procedure the Division of Ratepayer Advocates (DRA) hereby submits this Reply Brief in the above captioned proceeding.

The California Water Service Company (CWS) raised no material issues in its Opening Brief that DRA has not already disproved in its own Opening Brief. DRA will not repeat those arguments here, but provides further discussion on a number of CWS's inaccurate and misleading arguments regarding outstanding plant projects and return on equity.

I. PLANT ISSUES IN THE COAST SPRINGS SUB-DISTRICT

CWS stated for the first time in its Opening Brief that it now agrees with DRA's recommendation to review both project #14318 and #14319 through advice letters. DRA is heartened to hear this. However, CWS is silent on DRA's and interveners' position that the costs CWS seeks to recover are excessive and improper. DRA reiterates the need to have these advice letters capped at \$227,800 for project #14318, and \$114,000 for project #14319, as detailed in DRA's opening brief. (See DRA Opening Brief (OB), pp. 3-7.) Furthermore, DRA generally supports the arguments expressed by interveners Jeff Young and Marcos Pareas in their Opening Briefs.

II. RETURN ON EQUITY

DRA's recommendation of a return on equity (ROE) of 9.78% does not take into account any Water Revenue Adjustment Mechanism (WRAM) that may be implemented. (See DRA OB, pp. 8-16.) Pursuant to Administrative Law Judge McVicar's February 24, 2006 Ruling granting a Rule 48 request for an extension of time, DRA and CWS will be briefing WRAM issues in a separate filing. As will be detailed in the separate brief, if a WRAM is implemented CWS's ROE should be further reduced below DRA's original recommendation of 9.78%.

A. CWS's Analysis is Incorrect

CWS tries to justify its above-market ROE request of 12.2% by asserting that comparisons to gas utilities are appropriate and that it has extraordinary risk due to balancing account ratemaking.

1. Comparisons to Gas Utilities are Misleading and Result in a Flawed Analysis.

As DRA has extensively cited in its Opening Brief, the Commission has rejected the use of gas utilities in ROE models for water utilities. (See DRA OB, pp. 12-14.) These Commission's decisions are both historical and as recent as December 2005. (See *id.*) CWS has not shown any new factual situation or legal basis on which to distinguish the present case from the long line of Commission precedent disallowing the use of data from gas utilities in water utilities' ROE models.

CWS asserts that both gas and water utilities are regulated by the Commission. (See CWS OB, p. 24.) This is true but household movers and the placement of railroad crossing gates are also regulated by the Commission. Surely, water companies should not be compared to these activities when establishing a proper ROE.

CWS claims both gas and water spend money on pipes and reading meters. (See *id.*) Again this is true of many industries. Electric and telecommunication industries spend money on wires and when placing those wires underground they too spend money on pipes. Electric utilities similar to gas and water also have to read meters. None of these similarities is enough to justify the comparison of gas utilities to water utilities when modeling ROEs. The financial community typically looks to companies that are close peers in assessing the risk of a given industry. Gas utilities differ from water utilities in many particulars including source of supply, connections to an interstate and international market, contiguous (rather than district based) service territories, frequent combinations of gas utilities with electric utilities, and simple scale. California gas utilities serve far more customers than any California water company. The Commission should continue to rely on its well-established precedents of ignoring gas utility data when calculating water utilities' ROE.

Again, DRA's Opening Brief has extensively detailed why comparisons to gas utilities are incorrect when modeling the water utilities' ROE. (See DRA OB, pp. 12-15.) DRA will not repeat its full argument here but notes that CWS has provided nothing in its case to suggest that the Commission's both recent and long standing precedent needs to be overturned.

2. CWS has no Extraordinary Risks and should not be granted a risk premium.

CWS seeks an adder of 28 basis points because of a balancing account impact on the ROE. (See CWS OB, p. 27.) CWS's brief also discusses other supposed risk but does not seek any specific remedy in regards to those conditions. (See *id.* at 27-30, 33.) DRA's Opening Brief extensively addresses CWS's mistaken beliefs. (See DRA OB,

pp. 9-12.) CWA provides no new arguments in its brief and DRA will not repeat itself, but will respond to some of CWS's mistaken beliefs.

CWS only seeks a risk adder for the effect of balancing accounts. (See CWS OB, p. 27.) CWS's belief that these balancing accounts in conjunction with the earning test become caps on its earnings is incorrect. (See *id.* at 31-32, discussing D.03-06-072.) The earnings test is designed to limit utility windfalls it does not limit legitimate earnings and in no way does it limit CWS's opportunity to earn its authorized ROE. (See DRA OB, pp. 11-12.)

Furthermore, the earning test decision is currently being reviewed by the Commission. A draft decision was mailed on January 23, 2006 that would suspend the earning test adopted in D.03-06-072. This draft decision was on the agenda of the March 2, 2006 Commission meeting.¹ Assuming *arguendo*, that the earning test is an additional "risk," the Commission should not reward CWS 28 basis points for a "risk" that it will soon address in a separate proceeding.

While CWS only seeks relief for its supposed risk due to balancing accounts and the earnings test, its brief also states other phantom risks; such as, water quality standards; credit ratings; and, the size of districts.

As DRA detailed in its Opening Brief, there is no risk due to water quality standards. DRA will not protest reasonable expenditures to improve water quality, and the Commission has repeatedly stated its desire to ensure safe drinking water. (See DRA OB, pp. 9-10.) CWS's credit rating is investment grade and its outlook was recently upgraded. (See *id.* at 16.) Furthermore, investors do not invest in individual districts of the company they invest in the company as a whole and CWS is the largest water service IOU; thus, there is no extra risk due to small districts. (See *id.* at 11.)

¹ The agenda item was held for further review.

B. The Commission should adopt DRA's solid and reliable analysis.

DRA's recommendation of a 9.78% ROE is based on solid analysis using appropriate data. DRA uses data from comparable water utilities and does not reward CWS for illusory risks. (See DRA OB, pp. 9-16.)

CWS attempts to discredit DRA's analysis on the basis that DRA used a different time period for its dividend data. (See CWS OB, p. 20.) However, DRA used the most recent dividend data. Dividend data from the last quarter of 2005 was not available at the time DRA's testimony was due. Moreover, historical data is often more reliable than estimates of future data. DRA's data is historical enough to instill confidence in its accuracy while current enough to instill confidence in its relevancy.

CWS also complains that DRA didn't use the most recent Data Resource Inc. (DRI) report to forecast its interest rates. (See CWS OB, p. 22.) DRA used the most recent DRI report *in the record*, whereas CWS didn't even attempt to use the DRI report. (See DRA OB, p. 14.) The Commission has constantly accepted the DRI report as an interest rate forecast source in determining the cost of capital. (See *id.*)

Lastly, CWS attempts to discredit DRA's use of water utilities in its models, whereas CWS used water utilities and gas utilities. (See CWS OB, p. 22.) As extensively detailed in DRA Opening Brief, the use of non-water utilities in modeling water utility ROEs is expressly and consistently disallowed by the Commission. (See DRA OB, p. 13.) DRA's sample size of water utilities is large enough to instill confidence in its results. CWS's use of irrelevant gas utility data inputs into its models makes its analysis completely unreliable and untrustworthy.

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III. CONCLUSION

For the reasons stated here and in its Opening Brief and testimony, DRA respectfully requests that the Commission adopt DRA's recommendations. CWS projects #14318 and #14319 should be addressed through advice letters. CWS is a financially secure and healthy company. An ROE of 9.78%, (with an additional reduction if a WRAM is implemented), should be more than adequate to ensure CWS's continued success.

Respectfully submitted,

/s/ Jason Reiger

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March 9, 2006

CERTIFICATE OF SERVICE

I hereby certify that I have this day served a copy of **“REPLY BRIEF OF THE DIVISION OF RATEPAYER ADVOCATES”** in **Application 05-18-006, et al.** by using the following service:

[X] **E-MAIL SERVICE:** sending the entire document as an attachment to an e-mail message to all know parties of record to this proceeding who provided e-mail addresses and by

[X] **U.S. MAIL SERVICE:** mailing by first-class mail with postage prepaid to all known parties of record.

Executed in San Francisco, California, on the **9th** day of **March, 2006.**

/s/ NELLY SARMIENTO

NELLY SARMIENTO

N O T I C E

Parties should notify the Process Office, Public Utilities Commission, 505 Van Ness Avenue, Room 2000, San Francisco, CA 94102, of any change of address and/or e-mail address to insure that they continue to receive documents. You must indicate the proceeding number on the service list on which your name appears.
